

## Message Text

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INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-07

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LIMITED OFFICIAL USE SECTION 1 OF 2 EC BRUSSELS 4021

PASS AGRICULTURE

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SUBJECT: THE EC BUDGETARY CRISIS AND THE CAP

REF: (A) EC BRUSSELS 3667, (B) 75 EC BRUSSELS 10105, (C) EC BRUSSELS  
2390, (D) EC BRUSSELS 3568, (E) EC A-185, (F) 75 EC BRUSSELS  
8711

1. BEING SUMMARY: RECENT STATEMENTS BY LARDINOIS, COMBINED WITH HIS  
DECISION TO LEAVE HIS POST AT THE END OF 1976, HAVE RAISED THE SPECTR  
E  
OF A "COLLAPSE" OF THE CAP. LANDINOIS FEARS THAT, AS A RESULT  
OF A SURGE IN EC EXPENDITURES OWING TO THE SHARP DEPRECIATION OF  
THE LIRA AND THE POUND, A CEILING WILL BE PLAED ON EC AGRICULTURAL  
EXPENDITURES. IN HISVIEW, THE CAP WOULD NOT BE ABLE TO FUNCTION  
EFFECTIVELY WITH THAT LIMITATION. BURGEONING "AGRO-MONETARY"  
EXPENDITURES COULD ALSO TIE THE EC'S HANDS IN DEALING WITH THE  
DAIRY SURPLUS PRGBLEM. TO BRING THESE EXPENDITTURES UNDER CONTROL,  
THE COMMUNITY HAS THREE OPTIONS: DEVALUE THE GREEN RATE, REDUCE  
MONETARY COMPENSATORY AMOUNTS (MCAS), OR MAKE MEMBER STATES PAY A  
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LARGE PART OF THE COST OF MCAS. ALL OF THESE

OPTIONS WILL AROUSE STRONG OPPOSITION. BUT IF NO SUCH MEASURES ARE TAKEN, SOME SORT OF CEILING ON CAP EXPENDITURES COULD BECOME A VERY REAL POSSIBILITY. END SUMMARY.

2. THE PUBLICLY-ANNOUNCED DECISION BY EC COMMISSIONER FOR AGRICULTURE LARDINOIS NOT TO SEEK REAPPOINTMENT TO HIS PRESENT POST (REF A) IN 1977 FOLLOWED UNCONFIRMED REPORTS TO THIS EFFECT THAT HAD BEEN CIRCULATING FOR SOME TIME. EVEN SO, HIS DECISION SENT A MILD SHOCK-WAVE THROUGH THE COMMUNITY BECAUSE IT WAS UNEXPECTED AT THIS TIME AND ALSO BECAUSE IT COULD NOT HELP BUT INCREASE THE GLARE OF THE SPOTLIGHT ON THE MOUNTING PROBLEMS BESETTING THE COMMON AGRICULTURAL POLICY (CAP). WHILE WE BELIEVE THAT LARDINOIS HAD DECIDED SOME TIME AGO TO ACCEPT THE POSITION OF CHAIRMAN OF THE DUTCH RABOBANK, WE ALSO BELIEVE THAT AN IMPORTANT ELEMENT IN THAT DECISION WAS HIS DEEP CONCERN OVER THE FUTURE OF THE CAP -- PARTICULARLY OVER THE POSSIBILITY THAT THE COUNCIL WOULD PUT A CEILING ON THE COMMUNITY'S OPERATING AGRICULTURAL BUDGET. A FEW MONTHS AGO, LARDINOIS TOLD A MISSION OFFICER THAT HE WOULD RESIGN IF HE FELT THE IMPOSITION OF SUCH A CEILING WERE INEVITABLE. LARDINOIS HAS ALSO EXPRESSED GRAVE CONCERN ABOUT THE EFFECTS OF CONTINUED EC MONETARY DISARRAY, STATING THAT UNLESS THE SNAKE ARRANGEMENT IS REBUILT, "THE CAP WILL BE A DEAD LETTER BY THE END OF THE YEAR."

3. THE MONETARY DISTURBANCES OF RECENT YEARS AND THE RESULTANT SYSTEM OF MCAS HAVE, IN FACT, SHATTERED THE COMMUNITY'S COMMON FARM PRICE POLICY; THE SO-CALLED COMMON PRICE SET FOR AGRICULTURAL PRODUCTS

IN TERMS OF UNITS OF ACCOUNT IS A SHAM MASKING SEVEN NATIONAL PRICE SYSTEMS. THE RECENT DEPRECIATION OF THE POUND AND LIRA WILL, OF COURSE, MAKE ANY POSSIBLE FUTURE RETURN TO COMMON PRICES MUCH MORE DIFFICULT. HOWEVER, SINCE THE COMMUNITY HAS BECOME ACCUSTOMED IN RECENT YEARS TO DIFFERING NATIONAL PRICE LEVELS AND TO THE RE-APPEARANCE OF BARRIERS AND SUBSIDIES IN INTRA-COMMUNITY AGRICULTURAL TRADE, THE INCREASED DIVERGENCE BETWEEN MEMBER STATE FARM PRICES IS NOT LIKELY TO PROVOKE A SERIOUS CRISIS. DESPITE THE SYSTEM OF MCAS, THE PRINCIPLE OF COMMUNITY PREFERENCE HAS REMAINED INTACT AND INTRA-COMMUNITY AGRICULTURAL TRADE HAS FLOURISHED.

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4. A MUCH MORE SERIOUS THREAT TO THE CAP IS THE POTENTIAL IMPACT OF THE RECENT MONETARY DISTURBANCES ON THE EC BUDGET. THE GERMANS, WHO HAVE BEEN UNABLE TO DEVELOP A STRATEGY FOR A POLICY REFORM OF THE CAP (REF B), HAVE FOCUSED THEIR CRITICISM OF THE CAP ON THE ISSUE OF BUDGETARY CONTROL. THEIR RELUCTANT ACCEPTANCE OF THE 1976 BUDGET IN AUTUMN 1975 HAS SET THE STAGE FOR THEM TO PRESS FOR MAJOR CONCESSIONS ON EC BUDGET MANAGEMENT IF FURTHER FINANCIAL DEMANDS -- VIA SUPPLE-

MENTARY BUDGET APPROPRIATIONS -- ARE MADE ON THEM.

5. ABOUT 70 PERCENT OF THE TOTAL 1976 EC BUDGET OF 7.6 BILLION U.A. IS EARMARKED FOR AGRICULTURE. DAIRY SUPPORT MAKES UP BY FAR THE LARGEST COMPONENT OF EC EXPENDITURES ON AGRICULTURE. NEARLY 2 BILLION U.A. HAVE BEEN APPROPRIATED FOR DAIRY SUPPORT IN THE 1976 BUDGET -- ABOUT 38 PERCENT OF TOTAL AGRICULTURAL SUPPORT COSTS. AND MORE MONEY MAY BE NEEDED. WHILE COMMISSION SPOKESMEN HAVE THUS FAR INSISTED THAT THE EXISTING BUDGET IS ADEQUATE TO FUND THE PRICE AND POLICY DECISION TAKEN AT THE MRCH 2-6 MARATHON (REF C), THEY STILL EXPECT "MAJOR" POLICY DECISIONS TO BE TAKEN IN JULY TO DEAL WITH THE MASSIVE DAIRY SURPLUS PROBLEM. (ALSO, A SUPPLEMENTARY FOOD AID APPROPRIATION OF ROUGHLY 100 MILLION U.A. WILL HAVE TO BE APPROVED IF THE EC FOOD AID PROGRAM FOR NFDM IS EXPANDED TO 200,000 TONS.) WHILE THE ESTABLISHMENT OF "FINANCIAL PARTICIPATION FOR MILK PRODUCERS" (E.G., TAX ON MILK DELIVERY TO DAIRIES) COULD POSSIBLY REDUCE EC BUDGET COSTS, THE COUNCIL HAS INDICATED THAT THESE MEASURES SHOULD NOT TAKE EFFECT UNTIL THE 1977/78 DAIRY YEAR. OTHER PROPOSED MEASURES, SUCH AS PREMIUMS, FOR THE NON-MARKETING OF MILK AND FOR HERD CONVERSION, AIMED AT REMEDYING THE PROFOUND STRUCTURAL DEFICIENCIES OF THE EC DAIRY SECTOR COULD INCREASE COSTS IN THE CURRENT YEAR. THE BUDGET COULD ALSO BE UPSET IF HIGHER-THAN-ANTICIPATED 1976 EXPENDITURES ARE REQUIRED BY DEVELOPMENTS IN ONE OR MORE OF THE BASICALLY UNPREDICTABLE COMMODITY SECTORS, BEEF SUPPORT PURCHASES, FOR EXAMPLE, ARE CURRENTLY RUNNING MUCH HIGHER THAN EXPECTED. COMMISSION COST ESTIMATES TEND TO BE CONSERVATIVE, AND BASED ON THE BETTER OF POSSIBLE WORLDS, SO THIS IS ALWAYS A DISTINCT POSSIBILITY.

6. EXPENDITURE ON MCAS IS MUCH LESS THAN THAT ON DAIRY BUT THE SYSTEM OF MCAS IS A WILD CARD IN THE EC AGRICULTURAL LIMITED OFFICIAL USE

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BUDGET. ABOUT 260 MILLION U.A. HAVE BEEN APPROPRIATED FOR MCAS IN THE 1976 BUDGET, BUT LARDINOIS HAS STATED THAT THE RECENT DETERIORATION OF THE POUND AND LIRA COULD RESULT IN ADDITIONAL EXPENDITURES ON MCAS OF 500-600 MILLION U.A. (REF D). SUCH A LEAP IN MCA COSTS WOULD ABRUPTLY UNDERMINE THE PRECARIOUS BALANCE BETWEEN OPPOSING EC INTERESTS -- GERMAN AND UK BUDGETARY CONCERNS, FRENCH AND IRISH PRESSURES TO MAINTAIN FARM INCOME LEVELS, UK AND ITALIAN INFLATIONARY WORRIES AND THE WHOLE RANGE OF DIVERSE FARMER AND MEMBER STATE INTERESTS -- WHICH UNDERLIES THE 1976 EC BUDGET AND THE RECENTLY-ADOPTED FARM PRICE PACKAGE FOR 1976/77. IN ADDITION, IT WOULD TIE THE HANDS OF THE COMMUNITY IN DEALING WITH THE DAIRY PROBLEM AND THWART THE ALLOCATION OF FUNDS FOR STRUCTURAL REFORM OF THE DAIRY SECTOR.

7. MCAS RESULT FROM THE UNWILLINGNESS OF MEMBER STATES TO ALLOW NATIONAL FARM PRICES TO CHANGE IN LINE WITH CURRENCY FLUCTUATIONS. THEY COST THE COMMUNITY MONEY IN TWO WAYS: (1) AS IMPORT SUBSIDIES IN COUNTRIES WHERE CURRENCIES HAVE DEPRECIATED, AND (2) AS EXPORT SUBSIDIES IN COUNTRIES WHERE CURRENCIES HAVE APPRECIATED. CONVERSELY, MCAS ARE COLLECTED AS IMPORT TAXES IN COUNTRIES WITH APPRECIATED CURRENCIES AND, IN THESE CASES, PROVIDE ADDITIONAL REVENUE TO THE EC BUDGET. THUS, AN INCREASE IN MCAS APPLIED TO FRANCE -- A LARGE NET EXPORTER -- RESULTING FROM A DROP IN THE FRANC'S VALUE WOULD INCREASE FEOGA REVENUES WHILE AN INCREASE IN MCAS APPLICABLE TO THE UK -- A LARGE NET IMPORTER -- WOULD MEAN ADDITIONAL FEOGA EXPENDITURE. THE COSTS OF MCAS ROSE SHARPLY FROM 146 MILLION U.A. IN 1974 TO 335 MILLION U.A. IN 1975 AND WERE FAR IN EXCESS OF MCA REVENUES. HINTON

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INFO ALL EC CAPITALS 2033

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PASS AGRICULTURE

8. THE REDUCED 1976 APPROPRIATION FOR MCAS (260 MILLION U.A.) REFLECTS THE RATHER CALM -AGRO-MONETARY" SITUATION OF THE LAST PART OF 1975. MCAS ON ITALY WERE REMOVED IN AUGUST 1975 WHILE MCAS APPLICABLE TO THE UK WERE SUBSTANTIALLY REDUCED AS A RESULT OF SEVERAL DEVALUATIONS OF THE GREEN

POUND. BUT IN EARLY 1976, THE SITUATION BEGAN TO DETERIORATE RAPIDLY. MCAS ON ITALIAN FARM TRADE WERE REINTRODUCED IN FEBRUARY AND HAVE RISEN SINCE THEN TO 20.8-27.7 PERCENT. MCAS ON UK TRADE HAVE RISEN FROM 6.4-13.1 PERCENT AT THE START OF 1976 TO 17.4-24.7 PERCENT. (NOTE: THE ACTUAL AMOUNT OF THE MCA IS CALCULATED BY MULTIPLYING THE NATIONAL INTERVENTION PRICE BY THESE PERCENTAGES -- WHICH REFLECT THE DIVERGENCE BETWEEN THE GREEN RATE AND THE MARKET RATE OF A MEMBER STATE CURRENCY. THE PERCENTAGE RANGE RESULTS FROM THE FACT THAT THE NEW GREEN RATES AGREED ON AT THE MARCH 2-6 MARATHON ARE NOT YET BEING APPLIED FOR SOME COMMODITIES -- REF E. THE SMALLER FIGURE IS THE MCA APPLICABLE WHERE THE NEW GREEN RATES ARE IN EFFECT.)

IT IS, OF COURSE, THE BIG JUMP IN MCAS FOR THESE COUNTRIES -- BOTH LARGE NET IMPORTERS OF BASIC FARM PRODUCTS -- THAT IS LIMITED OFFICIAL USE

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CAUSING THE SWELLING OF EC EXPENDITURES. THE COMMISSION HAS ESTIMATED THAT EACH PERCENTAGE POINT DROP IN THE ITALIAN LIRA VIS-VIS THE GREEN RATE COSTS FEOGA 27 MILLION U.A. PER YEAR; EACH DROP OF A POINT IN THE UK POINT, 25 MILLION U.A. PER YEAR.

9. WHILE TALK OF A "COLLAPSE" OF THE CAP MAY BE EXAGGERATED, THE GERMANS CAN BE EXPECTED TO STRENOUSLY OPPOSE SUPPLEMENTARY APPROPRIATIONS OF 500 TO 600 MILLION U.A. (OR PERHAPS MORE) SOLELY FOR THE PURPOSE OF FUNDING MCA IMPORT SUBSIDIES IN ITALY AND THE UK. THEREFORE, THE COMMISSION MUST TRY TO TAKE SOME ACTION TO REDUCE THE SCOPE OF THIS PROBLEM. LARDINOIS WENT LAST WEEK TO ROME AND THIS WEEK TO LONDON TO DISCUSS POSSIBLE MEASURES. AS WE SEE THEM, THE EC OPTIONS IN THE SHORT-RUN ARE AS FOLLOWS:

(A) DEVALUE THE UK AND ITALIAN GREEN RATES;

(B) REDUCE MCAS WITHOUT FORMALLY DEVALUING GREEN RATES;

(C) INTRODUCE AN ELEMENT OF NATIONAL (I.E., UK AND ITALIAN) FINANCING INTO THE PAYMENT OF MCAS.

ALL OF THE ABOVE OPTIONS WOULD AROUSE SERIOUS OBJECTIONS. THE FIRST WOULD RESULT IN AN IMMEDIATE JUMP IN FARM AND FOOD PRICES IN ITALY AND THE UK -- IN ADDITION TO THE INCREASE JUST APPROVED -- AND COULD SERIOUSLY UNDERMINE THE EFFORTS OF BOTH COUNTRIES TO BRING DOWN THEIR INFLATION RATES. HOWEVER, INITIAL PRESS REPORTS OF LARDINOIS, ROME VISIT INDICATE ITALIAN WILLINGNESS TO CONSIDER PARTIAL DEVALUATION OF THE GREEN LIRA. OPPOSITION IS GREATER IN THE UK WHERE THE GOVERNMENT HAS ALREADY COME UNDER HEAVY FIRE FOR CONSENTING TO THE 1976/77 PRICE PACKAGE. THE SECOND ALTERNATIVE WOULD HAVE ESSENTIALLY THE SAME EFFECT ON CONSUMER PRICES AS A DEVALUATION OF GREEN RATES. BUT THESE EFFECTS COULD

BE OBSCURED BY COMPLICATED REGULATIONS AND THUS WOULD BE LESS VISIBLE AND PROBABLY LESS OFFENSIVE TO PUBLIC OPINION. THE THIRD ALTERNATIVE WOULD BE OPPOSED BY UK AND ITALIAN FINANCE MINISTERS AND HAMPER THEIR EFFORTS TO CURB GOVERNMENT EXPENDITURES. BUT THIS ROUTE WOULD PROBABLY CAUSE LESS POPULAR POLITICAL OBJECTION.

10. IN THE LONG RUN, MCAS CAN BE ELIMINATED ONLY BY THE ESTABLISH-LIMITED OFFICIAL USE

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MENT OF MONETARY UNION OR ITS EQUIVALENT OR BY A MAJOR SHIFT IN THE EMPHASIS OF EC FARM POLICY FROM PRICE TO INCOME SUPPORT. THE CHANCE OF SUCH FUNDAMENTAL DECISIONS BEING TAKEN IN THE FORESEEABLE FUTURE IS VERY DIM. THUS, MCAS, AND THE ATTENDANT FINANCIAL UNCERTAINTIES, CAN BE EXPECTED TO TROUBLE THE COMMUNITY FOR QUITE SOME TIME.

11. ASSUMING NO SUBSTANTIAL RECOVERY OF THE POUND OR LIRA AND EITHER (A) NONE OF THE THREE SHORT-TERM OPTIONS ARE IMPLEMENTED OR (B) DESPITE SUCH MEASURES, THE COST OF MCAS IS STILL VERY LARGE, THE PROSPECT OF A CEILING ON CAP EXPENDITURES -- SO UPSETTING TO LARDINOIS -- COULD BECOME REAL. BUT THIS DEPENDS ON HOW STRONGLY THE GERMANS PLAY THEIR HAND. (IN THE PAST, THEY HAVE NOT BEEN WILLING TO STAND FAST ON THIS ISSUE.) TECHNICALLY, A SUPPLEMENTARY BUDGET COULD BE APPROVED BY A MAJORITY VOTE OVER THE OPPOSITION OF THE GERMANS. (INDEED, THE GERMANS VOTED AGAINST THE 1976 BUDGET AND WERE OVERRULED BY THE OTHER EIGHT MEMBER STATES -- REF F. BUT IT WAS WIDELY ASSUMED AT THAT TIME THAT THE GERMANS WERE MERELY GESTURING.) HOWEVER, IT SEEMS HIGHLY UNLIKELY THAT OTHER MEMBER STATES WOULD ATTEMPT TO OVERRIDE SERIOUS GERMAN OPPOSITION IN THIS MANNER. A CEILING ON 1977 AGRICULTURAL EXPENDITURES COULD WELL BE THE GERMAN PRICE FOR ACQUIESCENCE TO SUPPLEMENTARY APPROPRIATIONS FOR 1976.

12. IMPOSITION OF SUCH A CEILING WOULD BE BASICALLY IN CONFLICT WITH THE EXISTING BODY OF FARM POLICY DECISIONS TAKEN BY THE COUNCIL AND IT IS DIFFICULT TO SEE HOW THIS ISSUE WOULD BE RESOLVED, CONSTITUTIONALLY AND PRACTICALLY. HOWEVER, A CEILING WOULD PROBABLY RESULT IN A PROLIFERATION OF NATIONAL MEASURES TO AID FARMERS AND IT WOULD REINFORCE EXISTING EC TENDENCIES TO SIT ON SURPLUSES (SINCE, ESSENTIALLY, ONLY EXPENDITURES FOR DISPOSAL OF SURPLUSES ARE CHARGED TO THE COMMUNITY), AND TO MINIMIZE EXPENDITURES ON STRUCTURAL REFORM. IT COULD ALSO RESULT IN THE INTRODUCTION OF SOME FORM OF PRODUCTION CONTROL AS A MEANS OF ALLOCATING THE LIMITED EC FUNDS AVAILABLE. WHETHER THIS WOULD CONSTITUTE A "COLLAPSE" OF THE CAP OR JUST A FURTHER RENDING OF AN ALREADY TATTERED GARMENT DEPENDS ON ONE'S POINT OF VIEW.

13. WE SHOULD ALSO NOT IGNORE AN ELEMENT OF CALCULATION IN LARDINOIS' RECENT COMMENTS. HE KNOWS THAT THE MEMBER STATES

ACT ONLY IN A CRISIS ATMOSPHERE. TALK OF THE IMINENT COLLAPSE OF  
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THE CAP IS PERHAPS NOT A BAD WAY OF PREPARING THE TERMANS TO BE  
LESS STINGY IN THEIR BUDGETARY CONSIDERATIONS, THE ITALIANS AND  
THE UK TO PAY PART OF THE PRICE OF THEIR CURRENCY DEPRECIATIONS, AND  
THE FRENCH, IRISH, DUTCH AND DANES TO ACCEPT PRODUCER CO-  
RESPONSIBILITY. AT THE SAME TIME, BY THROWING THE SPOTLIGHT ON  
A PROBLEM IN WHICH THE EC'S AGRICULTURAL POLICY IS RELATIVELY BLAME-  
LESS, IT MAKES THE CAP THE VICTIM OF EC INDECISIVENESS AND  
INCOHESION -- RATHER THAN AN OUTRAGE TO ECONOMIC LOGIC AND  
A BURDEN TO TAXPAYERS AND CONSUMERS.HINTON

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## Message Attributes

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